Non-technical Summary

Project Title:
Vertical Differentiation in the PC Software Market: Should Product Bundling Be Socially Plausible If It Does not Lead to Efficient Market Foreclosure?

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Short Description
The social welfare effect of tying a low-quality to a high-quality complementary product in a vertically differentiated market for systems

Full Description

What are the main market conditions (in terms of market size and qualities) at which tying could be driven by sales-saving rather than predatory incentives? What would be the social welfare effect of tying in such a case?

The present paper steps on the assumption that PC software systems are vertically differentiated to show that in this case the tying behavior of Microsoft during the so called "browser wars" in the 1990s could have been motivated by own-sales-saving rather than predatory (entry-deterrence) incentives. The main objective of the paper is to measure the welfare effect of product tying in the case when it could be considered as a defensive strategy by the multi-product firm.

The main findings in the chapter are that:

- tying could be motivated by sales-saving incentives given sufficiently narrow market size and exogenously restricted range in which the low-quality good of the multi-product firm could vary.
- tying arrangement maximizes the multi-product firm's profit but leaves the market non-covered which has a negative partial effect on the social welfare.
- tying has also a potential to improve the social welfare by increasing the average quality offered in the market.
- the non-tying subgame equilibrium is strictly Pareto dominated by the tying outcome.

The main corollary of the paper is that making Microsoft supply a Linux version of its application software emerges as a stronger competition-enhancing policy measure than unbundling.